

**DEPARTMENT OF REVENUE
LETTER RULING # 99-03**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Application of the sales and use tax to electrical components purchased for building renovations.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the commissioner at any time.

Such revocations or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and

(E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

[THE TAXPAYER] has entered into a contract with an agency of the federal government to renovate [A BUILDING] in [CITY], Tennessee. The work will include the adaptive reuse of an existing [DESCRIPTION OF FACILITIES] as new offices. Building renovations will require [DESCRIPTION OF RENOVATIONS].

The building renovations will also require that the existing electrical system be renovated and expanded to accommodate the additional voltage demands upon the system. A series of “step-down” transformers will be installed within the new electrical system in order to convert the high voltage supply from the transmission source to lower, usable voltages within the offices.

ISSUE

Whether the expanded and renovated electrical system qualifies as an “electrical distribution system” so that its components are exempt from sales or use tax.

RULING

The expanded and renovated electrical system does not qualify as an “electrical distribution system” and all components are accordingly subject to applicable sales or use tax.

ANALYSIS

Tenn. Code Ann. § 67-6-209(e) states:

There is hereby exempt from the provisions of this chapter the sale or use of materials and equipment purchased or used for construction or installation, by a contractor, subcontractor or otherwise, of, in or as a part of any electric generating plant or distribution system . . . owned or operated by the United States
. . . .

The general rule of contractor use tax liability on a realty construction project for a governmental entity is that the contractor absorbs the cost of materials,

including the taxes due on the cost of those materials, utilized in fulfilling the government contract. *U.S. v. Boyd*, 378 U.S. 39, 84 S.Ct. 1518, 12 L. Ed. 2d. 713 (1964). Additionally, the rule construing the statute provides that

[t]angible personal property which actually becomes a component part of an electric generating plant or distribution system owned or operated by the United States or any of its agencies . . . is exempt from the Sales or Use Tax. This exemption applies without regard to who purchases the tangible personal property, and without regard to the form of any contract involved for the installation of the property as a part of such a system. The exemption provided for herein does not apply to any tangible personal property or taxable service which is used in the process of installing the exempt property, when such property does not become a component part of the electric generating plant or distribution system.

Tenn. Comp. R. & Regs. 1320-5-1-1.02(1).

Accordingly, the items the Taxpayer purchases will be exempt only if they are components of an electric generating plant or distribution system. Although these terms are not defined in the sales tax law, other sections of the Tennessee Code provide guidance. Tenn. Code Ann. § 7-52-102(3) defines an electric plant as

generating and/or transmission and/or distribution systems, together with all other facilities, equipment and appurtenances necessary or appropriate to any such systems for the furnishing of electric power and energy for lighting, heating, power or any other purpose for which electric power and energy can be used.

Only those items of tangible personal property that become component parts of the electric system are exempt. Tenn. Comp. R. & Regs. 1320-5-1-1.02(1). Tangible personal property which is not somehow specially needed, related or unique to the operation of an electric generating plant cannot be “necessary” to the plant within the definition in Tenn. Code Ann. § 7-52-102(3). This statute supports the exclusion from the exemption in Tenn. Comp. R. & Regs. 1320-5-1-1.02(1) for equipment such as tools or other items used to install the components of the electric system. Clearly, the renovations in question do not qualify as an electric generating plant. The inquiry, then, is whether the renovations include an electric distribution system.

The common understanding of an electric distribution system is a system that supplies and distributes electricity to a number of users in a particular area. “Distribute” is defined in part as

1. to divide among several or many . . . 2.b: to give out or deliver
esp. to members of a group . . . implies an apportioning by
separation of something into parts, units, or amounts.

Webster's Ninth New Collegiate Dictionary, 1987. Distributing electrical power, then, means that the system carries electricity and divides or delivers it to various places. Inherent in the meaning of a distribution system is that electricity will be distributed, i.e., not carried and directed within a lone recipient. The Department has applied the exemption to a distribution system that is not on private property and will include in the system all components from the source of the electricity through and including the transformers that lead to each building. Wiring within a building does not qualify for this exemption.

Supplying a single building with electrical current by tapping into a pre-existing underground supply line does not constitute distributing electrical power from a generating source based on the common understanding of an electrical distribution system. The materials used in renovating the electrical system of a single building, therefore, cannot be regarded as electrical components within a "generating plant" or "distribution system". The contractor owes use tax on the cost of materials used in fulfilling a contract for construction of the electrical equipment used in such buildings or facilities. Tenn. Code Ann. § 67-6-209(b).

Accordingly, the renovations of [THE BUILDING] do not constitute an electric distribution system and do not qualify for the exemption .

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APPROVED: Ruth E. Johnson, Commissioner

DATE: 1-29-99